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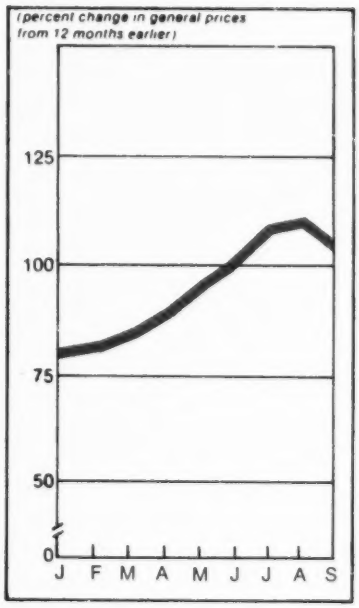
The Outlook For Brazil

There is no difficulty in explaining the increased concern over Brazil's short-term economic prospects. The rate of inflation has risen to a 16-year high of over 100%, and this year's current-account deficit is likely to reach $12½ billion, up $2 billion from 1979. By yearend, Brazil's foreign debt, the largest among the developing countries, will exceed $55 billion. Furthermore, the Iraq-Iran war has forced Brazil to seek new sources to replace the 20% of Brazilian oil imports interrupted by the conflict. In these circumstances, it is hardly surprising that forecasts of the performance of the Brazilian economy are becoming less optimistic. Indeed, one forecast projects inflation to accelerate substantially and real output to decline in 1981.

Brazilian inflation



Although there is little question that the growth of the Brazilian economy is slowing—and could fall short next year of the 4% rate thought to be the minimum needed to prevent a noticeable increase in unemployment—a forecast of greatly accelerated inflation and a fall in real output appears much too pessimistic. A projection of negative growth must presume an abrupt change in the willingness of the international financial community to acquire Brazilian debt. Such a scenario is highly unlikely to unfold in the near future. Thus far, Brazil has been able to fund roughly three-fourths of this year's borrowing needs, and most foreign lenders appear to remain cautiously optimistic that Brazil will carry out policies that are sufficiently restrictive to bring the trade balance and inflation under control.

The momentum of the Brazilian economy at this time is such that without the tough measures that are being taken to curb aggregate demand, foreign borrowing requirements would quickly escalate to unsustainable levels. In this event, the resultant falloff in the supply of foreign loans would force a lengthy period of extreme austerity characterized by highly unsatisfactory, although positive, economic growth rates. The initial steps toward controlling inflation and improving the balance of payments have been taken. Persistent implementation of these measures is the next challenge. In any event, Brazil's long-run growth potential remains impressive, and this argues for a measure of patience on the part of the international financial community.

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Italy's new coalition government expected to reimpose selected tax increases.

Italy's newly formed coalition government of Christian Democrat Arnaldo Forlani is faced with several pressing economic problems. The rate of inflation exceeded 21% in the 12 months through August, industrial output in August was 5.2% below its year-earlier level, and the trade deficit for January through August totaled more than 11 trillion lira ($12.8 billion), versus 1.1 trillion lira in the corresponding 1979 period. The new government will attempt to salvage sections of the July economic package, whose failure to win parliamentary approval was the immediate cause of the previous government's fall. It will probably attempt to reimpose the July increases in the rates of the value added tax and the excise tax on gasoline that were rescinded in early October. The chances of achieving cuts in public spending or rises in the rate of income tax appear less promising. Consequently, the burden of stabilization policy will continue to fall on the Bank of Italy, which raised the discount rate to 16.5% immediately after the last government's fall to forestall speculation against the lira.

Swiss inflation outlook improves, despite sharp rises in domestic costs.

Recent data point to an improved inflation outlook in Switzerland. The consumer price index in September stood at 3.8% above its year-earlier level, and wholesale prices rose at an annual rate of only 0.5% in the June-August period. The major causes of the apparent improvement, however, have been external. The cost of imported raw materials has declined, as have the energy-related components of the price indexes. But domestic costs continue to rise sharply, and there is mounting business concern over growing wage bills. The Swiss National Bank recognizes the threat of domestically generated inflation and is expected to maintain a restrictive monetary policy through the winter wage round. Some relaxation, however, should occur in early 1981 when the impact of the current recession in Germany is felt in Switzerland. Scope will then exist for a decline in interest rates in response to weaker credit demand.

Canadian trade showing strong, but 1980 current-account deficit will widen.

Canada's foreign trade performance is relatively strong in this recession year. Reasons include the domestic demand slowdown itself, which has led to a decline in real import volume, and the faster upward movement of export prices relative to import costs. These influences have contributed to a merchandise trade surplus of C$4.5 billion for the first seven months of this year, compared with a trade surplus of just under C$4 billion for all of 1979. Export prices have been notably strong for wheat, metals and minerals, and forest products. The Canadian trade gains have offset some of the C$1-billion rise in the services deficit in the first half of this year. A continuation of these trade trends will limit the size of the overall current-account deficit for 1980, although the shortfall is still expected to exceed the C$5.1-billion current-account gap of last year.

Indian economy hit hard by the Iran-Iraq conflict.

The disruption of oil supplies precipitated by the Iran-Iraq conflict poses a serious threat to the Indian economy. Iran and Iraq together had satisfied nearly two-thirds of Indian oil import requirements, and since India is relatively near to the Gulf, it was hit sooner than most other countries by the cutoff in supplies. India is currently scrambling to obtain 350,000 tons of crude oil and 125,000 tons of refined products on the spot market. It has also approached other oil-exporting countries, and Kuwait and Bulgaria have agreed to make up some of the shortfall at market prices. The Soviet Union, however, has indicated that it is unable to provide immediate aid. The higher prices paid for oil imports will boost the Indian oil bill above the $6-$7 billion already projected for the fiscal year. Consequently, a trade deficit of more than $4 billion in fiscal 1980/81 is virtually assured, unless non-oil imports are severely restrained. The urgency of the situation has put the Gandhi Government under increasing pressure to resolve the 11-month dispute in Assam that has cut off one-third of India's domestic production. It is also likely to prompt the authorities to move more quickly in opening exploration blocks to foreign oil companies.

Holland's rising unemployment and inflation spurs reassessment of fiscal policy.

Rapidly rising unemployment in Holland combined with accelerating inflation —consumer prices rose 7% in the 12 months through August—have prompted a debate on the nature of fiscal policy and the role of wage indexation. The relatively restrictive 1980 incomes policy, whereby wage increases are limited to rises in the cost of living, will not be maintained in 1981. But the government has consented to present to the trade unions plans for amending the 1981 draft budget. Specific proposals call for a substantial relaxation of the Dutch system of wage indexation in return for wide-ranging income tax cuts. Such tax reductions would be covered partly by rises in indirect taxes, including the value added tax, and partly by increased public borrowing. If these proposals are accepted, the actual 1981 budget deficit will exceed the originally proposed 13.1-billion guilder shortfall. And since the economy is on the verge of recession, the actual 1981 budget gap may even exceed the estimated 14.7-billion guilder budget deficit for 1980.

Venezuelan recession may result in real GDP contraction of 2% this year.

The Venezuelan economy continues in recession. According to statistics for the first half of 1980, automobile and cement sales, reliable indicators of industrial and construction activity, dropped 10% and 2% from their year-earlier levels. Petroleum production has also declined, in contrast to its upsurge a year ago, with output averaging 2.1 million barrels per day through end-September, compared with 2.3 million during the same period in 1979. Economic activity is unlikely to pick up in the second half because the authorities are pursuing a restrictive fiscal policy, and because of an uncertain business environment. Consequently, real GDP may decline by about 2% this year, after registering growth of less than 1% in 1979. And although the year-over-year rate of inflation reached 24% by June, the monthly increments have been decelerating recently. Thus, barring the renewal of price decontrol, the inflation rate may slow to about 20% by yearend.

Singapore is well-cushioned against economic downturn.

Singapore's economy has been barely affected by the current economic downturn in the industrialized nations. The economic growth rate this year is expected to reach at least 8%, largely on the strength of a burgeoning business and financial services sector and a property market boom. Manufacturing, growing at about 13%, is also doing well, with the electronics and transport industries setting the pace. Singapore's good fortunes rest on two cornerstones. First, it has carved out for itself a comfortable niche in the regional economy, servicing the development needs of its two well-endowed neighbors, Indonesia and Malaysia. And second, the government's well-orchestrated program to boost certain high-technology industries has attracted foreign investors and pushed Singapore a step ahead of other Asian competitors in the technological race. These twin strengths should help Singapore sustain its current fast-paced development through 1981 and beyond.

Algerian energy development plans shift in response to higher oil prices.

Rising oil prices have led to Algeria to reassess its energy development policies. Previous plans called for the development of gas resources at the greatest possible speed by constructing several liquefied natural gas plants for export of LNG to Europe and the United States. Such plans would have entailed heavy Algerian investment in plants as well as LNG carriers. Higher oil revenues, however, have brought about significant policy changes. Plans for the extraction of all forms of gas have been pared—although current production is expanding—and there has been a shift toward pipeline gas exports, instead of LNG. Pipeline gas generally commands a higher f.o.b. price, and shifts the burden of investment more to the consuming country. These new energy policies are expected to keep Algeria's current account in approximate balance over the long term. Although Algeria will probably return to the international capital market in 1981, future borrowing levels will most likely be low, averaging $2-$3 billion per year, a level sufficient merely to roll over maturing debt.

The Elusive Balanced Budget

News is just about to break concerning the exact size of the fiscal 1980 federal budget deficit. And it will be a huge one. The Office of Management and Budget (OMB) is due to release the official figures later this week. However, private economists have already estimated that the deficit for fiscal 1980, which ended September 30, may be as high as $65 billion. This would be some 63% greater than OMB's $40-billion projection of the 1980 deficit made last January.

Much of the unexpected swelling of the deficit has been blamed on the recession, and rightfully so. As unemployment rises during a recession, spending associated with various federal income maintenance programs goes up. And as business activity slows, so does the flow of revenues into federal coffers.

But the recession was not the only contributor to the higher-than-expected federal spending in 1980. Military and political turmoil in Afghanistan, Iran, and other areas of the Middle East prompted an explicit change in defense policy. Estimates of U.S. military defense spending for 1980 had to be revised upward by almost 4½% between the beginning of the year and late summer, accounting for over one-fourth of the increase in the projected deficit. Furthermore, in its zeal to protect federal spending programs from the ravages of inflation, Congress has further complicated the task of achieving a balanced budget. More than 75% of all government outlays are now indexed in some way to the inflation rate, so that when prices go up, government expenditures rise as well.

There are now encouraging signs that an economic recovery is already under way. However, the turnaround is not likely to be sufficient to bring about any significant reduction in Washington's red ink over the next year. On the revenue side, pressures for tax relief have by no means subsided. And although it is impossible at this point to predict the exact size of any tax cut, the form it will take, or when it might take effect, all of the proposals that have been put forth thus far would contribute significantly to the expected shortfall between receipts and spending. As for expenditures, the renewed interest in supplementing American military readiness will likely protect the defense budget from any serious Congressional cost-cutting efforts in fiscal 1981. And the prospect of continued high inflation limits the extent to which policymakers can economize elsewhere.

Consequently, although fiscal 1981 was targeted by the Carter Administration as the year in which budget balance would be achieved, it is not likely to come any closer to that goal than did the fiscal 1980 budget. And it will mark the 13th consecutive year in which a federal deficit is recorded.

Latin America Bimonthly Survey of Business and Finance

COUNTRIES	CURRENT BUSINESS CONDITIONS	EXPORTS		GNP IN 1979		BALANCE				
		6 months ending	change from year earlier	in billions of dollars	per capita	latest data	reserves (less gold) in million $	12-month change	months of imports covered	u c lia
Argentina	Declines in industrial and farm output produce 2.9% GDP drop in second quarter.	June	— 27%	102.1	$3,825	June	8,142	+ 8%	11.8	
Brazil	Restraints placed on wage increases to help curb 100%+ inflation rate.	June	+ 35%	209.1	1,760	May	5,789	— 46%	2.8	
Chile	Real GDP growth expected to slow to 5% in 1980 from record 8.5% in 1979.	July	+ 44%	20.6	1,860	Aug.	2,812	+ 75%	6.8	
Colombia	Measures taken to reduce tax burden on coffee exporters.	June	+ 21%	28.2	1,070	Aug.	4,383	+ 31%	10.7	
Costa Rica	Economic growth slowing in response to tightening of fiscal and monetary policy.	June	+ 12%	3.9	1,760	July	77	— 13%	0.7	
Ecuador	Manufacturing activity and government spending boost the economy.	Feb.	+ 51%	8.7	1,070	Aug.	979	+ 42%	5.6	
Guatemala	Monetary council injects more than $100 million into commercial banking system.	Dec.	+ 9%	7.2	1,060	Aug.	558	— 20%	7.1	
Honduras	Government undertaking international campaign to promote tourism.	Mar.	+ 27%	1.9	540	June	228	+ 21%	1.6	
Guyana	Special IMF/World Bank cooperation program will aid economic development.	Dec.	+ 12%	.5	625	July	14	— 70%	0.4	
Haiti	Local assembly industry and aid inflows help economy.	Oct. '79	+ 1%	1.5	300	Mar.	44	— 15%	n.a.	
Jamaica	Economic deterioration continues; presidential election set for October 30.	Apr.	+ 13%	2.7	1,230	July	165	+ 69%	1.9	3
Mexico	Overall level of economic activity high, but agricultural and electrical output lagging.	July	+ 83%	117.9	1,700	Apr.	2,298	+ 11%	1.3	
Nicaragua	Agricultural production up to 70% of pre-war level.	Dec.	— 5%	1.7	660	Nov.	85	+ 42%	1.7	
Panama	Wage increases and higher farm supports boost price level.	May	+ 34%	2.7	1,420	July	82	— 63%	0.7	
Paraguay	Restrictive monetary and fiscal measures hold inflation to 6.9% in first half of 1980.	July	— 17%	3.7	1,225	Aug.	733	+ 27%	15.5	
Peru	Wage increases permitted to restore purchasing power, but price decontrol continues.	Mar.	+ 66%	12.1	700	June	1,824	+243%	9.0	5
Puerto Rico	Real GDP growth slowed to 2.3% in fiscal year ending June 1980.	June	0	10.2	2,925	Aug.	8,372*	+ 9%	21.0	
Venezuela	Foreign reinvestment exceeding Andean Pact limit of 7% of original capital outlay is approved.	May	+ 49%	45.2	3,350	Aug.	8,108	+ 57%	9.1	

*Commercial bank deposits

Business Borrowing Shifts Back to Banks

Business loan growth at banks has accelerated sharply since early summer. This acceleration does not, however, reflect a widening of the "gap" between capital expenditures and internally generated funds at nonfinancial corporations. Rather, it reflects a shifting in the sources, and to some extent the uses, of funds raised by corporations.

Since early July, business loans at large banks have grown at a seasonally adjusted annual rate of 18%. This compares with a 7% decline in such loans from early April to early July. Yet based on limited data on corporate profits and capital expenditures in the third quarter, it appears that the difference between capital expenditures and internally generated funds of nonfinancial corporations (or the "financing gap") was actually below that of the second quarter by as much as 68%. This contrasts with the usual positive correlation observed between this financing gap and business loan growth.

There are a number of reasons for this somewhat atypical behavior of loans. For one, businesses have increased their holdings of financial assets in the third quarter; in the second quarter, these holdings were actually run down at a seasonally adjusted annual rate of $19.4 billion.

More importantly, the composition of nonfinancial corporate liabilities shifted dramatically. First, there is clear evidence that the debt maturity lengthening that began last spring was sharply curtailed during the third quarter. New issues of corporate bonds fell substantially from their record increases during the second quarter, with successive monthly declines during July through September. Second, there was a significant shift in the composition of short-term liabilities. Nonfinancial corporations liquidated short-term commercial paper during the third quarter, after issuing paper in the second quarter at a $20.2-billion seasonally adjusted annual rate.

This shift in liability composition reflects several changes in conditions of credit availability. For one, long-term bond rates have risen sharply since mid-June. Given this increased cost of long-term funding, many firms have postponed new debt issues until interest rates move down. For another, there was a significant decline in the cost of borrowing at banks relative to the cost of raising funds in the commercial paper market. For example, the spread between the prime rate and the 90-day commercial paper rate fell from 700 basis points in May to 130 basis points in September. This decline reflected to some extent the lowering of reserve requirements, which reduced the reserve "tax" on funds raised by banks.

In sum, much of the recent strength in bank loans stems from two forces. First, firms have engaged in temporary short-term financing in the expectation that bond market conditions improve. Second, bank loans have become more attractive relative to other short-term alternatives.

F PAYMENTS		MONEY AND BANKING							COUNTRIES
of IMF dit, mil- of dollars	current influences on payments	12-month changes: latest data	consumer prices	latest data	money supply(M_1)	exchange rate in U.S. dollars October 22, 1980	change from year earlier	current monetary conditions	
)	Mini-devaluation rate set at 1% monthly.	Sept.	+ 84%	Apr.	+146%	.00052	—22%	Interest rates decline slightly.	Argentina
)	Minimum financing terms imposed on imports.	Sept.	+104%	Aug.	+ 76%	.0175	—47%	Cruzeiro loans limited.	Brazil
)	Current-account deficit of $1.3 billion expected for 1980.	Aug.	+ 33%	June	+ 65%	.0270	+ 5%	Net foreign assets rising.	Chile
)	Jan.-July coffee exports up 37% above year-earlier level.	June	+ 28%	Mar.	+ 31%	.0230	—1!%	Credit crunch easing.	Colombia
)	Dual exchange rate in effect to stem import growth.	June	+ 19%	June	+ 8%	.1200	+ 3%	Credit policy is restrictive.	Costa Rica
)	Industrial exports show large increase.	June	+ 12%	May	+ 25%	.0385	— 4%	Pace of import financing steps up.	Ecuador
)	Foreign-exchange rules tightened for travel abroad.	July	+ 12%	June	+ 19%	Par	—	Reserve requirements lowered.	Guatemala
)	Coffee export receipts likely to reach $230 million in 1980.	Apr.	+ 22%	June	0	.5010	0	Monetary policy is restrictive.	Honduras
)	Higher sugar prices help export earnings.	Mar.	+ 17%	July	+ 6%	.4000	+ 2%	Monetary growth restricted.	Guyana
)	Toy and sporting goods exports increasing.	Mar.	+ 22%	Mar. '79	0	.2010	+ 1%	Increased monetization of economic activity.	Haiti
)	Jan.-Sept. bauxite exports were 9% below year-ago level.	May	+ 26%	Apr.	+ 29%	.5700	+ 2%	Net foreign assets decline further.	Jamaica
)	Oil exports reach 60% of total foreign sales.	July	+ 28%	Apr.	+ 25%	.0433	— 1%	Eurodollar borrowing increases.	Mexico
)	New credit restrictions adopted to reduce imports.	Dec.	+ 30%	Aug.'79	+ 56%	.1010	+ 1%	Liquidity is tight.	Nicaragua
)	Merchandise imports have doubled since 1979.	June	+ 13%	Apr.	+ 11%	Par	—	Demand for credit is strong.	Panama
)	Capital inflows more than offset trade deficit.	May	+ 34%	Feb.	+ 22%	.0080	+ 1%	Guaiani financing very limited.	Paraguay
)	Cumulative 1980 trade surplus is $1.5 billion to date.	Mar.	+ 60%	Mar.	+ 87%	.0039	—21%	Credit growth is limited.	Peru
)	Tourism this past summer down 12% from year ago.	Aug.	+ 7%	Aug.	+ 9%	Par	—	Credit growth is moderate.	Puerto Rico
)	Import demand remains depressed.	July	+ 24%	May	+ 13%	.2329	0	Net foreign assets rising.	Venezuela

World Interest Rates

market rates of Oct. 22, 1980; bond yields as of Oct. 17, 1980

in percent per annum	U.S.	Canada	Britain	Belgium	France	Germany	Italy	Netherlands	Switzerland	Japan
Central Bank Discount Rate	11.00	11.60	16.00	12.00	9.50	7.50	16.50 penalty rate 19.50	8.00	3.00	8.25
Day-to-Day Money	12.9375 Oct. 23	11.75	18.50	11.50	11.125	9.05	17.875	9.00	0.75	11.125
Treasury Bills 91-day, Middle Rates	11.76	11.30	14.25	12.10	12.60 one-year	n. a.	15.80 101-day	no dealing	no market	6.375 2-month
Commercial Paper prime, 3-month, asked	11.75 finance paper	11.30 finance paper 15% tax w/h	14.07	11.60 Certified	11.6875 Interbank	no market	no market	no market	no market	not traded
Bankers' Acceptances 3-month, asked	12.50	11.35 15% tax w/h	15.9375	11.60 Certified	not traded	9.90	21.50	no market	4.50	no market
Government Bonds Long-term, new and old issues, average yield	11.41	13.10	12.95	11.085 20% tax w/h	13.57	8.29	16.13	10.05	4.74	8.60
Industrial Bonds prime, long-term, new and old issues, average yield	12.45 Aa Industrials	13.75	13.78	15.815	14.43	8.38	16.38	10.99	5.6875	7.30
Bank Short-Term Rate to Best Borrowers (prime rate)	14.00	12.75	17.00	15.75	13.85	11.50	21.00	11.00	5.50	8.50
Bank Time Deposits 3-month	12.50 Cert. of Dep.	11.15 Cert. of Dep.	16.125	12.10	11.6875	8.75	10.75	9.375 large deposits	5.125 residents only	6.00 20% tax w/h
Eurocurrencies 3-month, asked	13.5625	no market	16.375	no market	12.00	8.75	no market	9.50	5.3125	no market
Exchange Rates—in U.S.$ rates floating against the $	—	.8554	2.4320	.0334	.2336	.5363	.001133	.4935	.6015	.004780
Forward Exchange Cover 3-month, in percent p.a. *D* = discount, *P* = premium	—	2.375 *P*	3.00 *D*	.125 *P*	1.75 *P*	4.50 *P*	8.375 *D*	4.00 *P*	8.125 *P*	3.50 *P*

Eurodollar Deposits
(London, interbank, bid)

Oct. 23	
7-day	14.75
1-month	14.125
3-month	13.5625
6-month	13.50

International Arbitrage
(3-month, hedged) + *in favor of U.S. dollars*

U.S.-U.K. Treasury Bills	+3.635
U.S.-Canada Treasury Bills	−1.455
U.S.-Canada Finance Co. Paper	−1.77
Eurodollars-U.K. Local Auth. Deposits	+ .123

Eurobonds
(average yield on recent straight debt issues)

U.S. Dollar Bonds	
7 yrs. and under	12.50*
Over 7 yrs.	13.40*
DM Bonds	
7 yrs. and under	8.75*
Over 7 yrs.	8.75*

Gold Price
London afternoon fixing
660.00
(per fine ounce)

The above interest rate quotations refer to the past week and may not be construed as offers by The Chase Manhattan Bank. The quotations for Bank Short-Term Rate to Best Customers, while including customary commissions, reflect neither possible other fees nor varying compensating balance requirements.
* Bond yields as of Oct. 10.

Current economic indicators of major industrial countries

	U.S.	Canada	Britain	France	Germany	Italy	Switzerland	Japan
Consumer prices*	12.8 (Aug.)	10.7 (Sept.)	15.9 (Sept.)	13.6 (Aug.)	5.2 (Sept.)	21.2 (Sept.)	3.8 (Sept.)	8.7 (Aug.)
Industrial production*	−6.7 (Sept.)	−4.0 (July)	−8.1 (Aug.)	−3.6 (July-Aug.)	−1.0 (Aug.)	5.2 (Aug.)	9.0 (Mar.)	2.0 (Aug.)
Trade balance† *(billions of local currency units)*	−$1.06 (Aug.)	C$1.04 (Aug.)	£0.37 (Sept.)	−FF5.44 (Sept.)	−DM0.13 (Aug.)	−Lit.1,630 (Aug.)	−SF1.10 (Sept.)	¥412 (Sept.)
Money supply (M_1)*	4.5 (June)	3.8 (July)	2.8 (June)	8.5 (May)	1.6 (June)	19.9 (Apr.)	−11.4 (July)	0.6 (June)
Velocity of money (M_1)*	3.5 (June)	10.7 (June)	11.7 (Mar.)	n. a.	5.8 (June)	4.3 (Mar.)	n. a.	5.7 (June)
Reserves minus gold *($ million, change from previous month)*	750 (Aug.)	−278 (July)	34 (Aug.)	321 (Aug.)	33 (Aug.)	−1,131 (Aug.)	−310 (Aug.)	254 (Aug.)

* Percent change from 12 months earlier.
† Figures are only for the month indicated.

Angola: An Economy Reemerging

Despite its military ties with the Soviet Union and Cuba, the newly independent African nation of Angola has refused to join the COMECON group and is actively cultivating commercial relations with the West. The former Portuguese colony, which achieved independence in 1975, has established official relations with virtually all of Western Europe and has forged commercial ties with the United States in an effort to obtain economic, technical, and financial assistance. Such aid is sorely needed by the Angolans to rebuild an economy that has yet to recover from its severe contraction following the exodus of the Portuguese and a protracted period of civil war. The country's ace-in-the-hole, however, is its rich agricultural and mineral-resource base, and especially its oil.

Angola's oil sector has clearly spearheaded the economic recovery that has occurred to date. Although oil production returned to its pre-independence level as early as 1977 and continues to expand steadily, all other economic sectors—agriculture, industry, and non-oil minerals—remain depressed. Significantly, Angola, which prior to independence was totally self-sufficient in food, has become heavily dependent on imports.

Official statistics on Angola's economic performance are unavailable, but it appears that 1978 marked the first year of economic growth since independence was won and a program of comprehensive nationalization was undertaken. Real GDP growth reportedly exceeded 20% in 1978 and in 1979, but 1978 GDP in constant prices was nearly 40% below the level prevailing in 1971.

The government's efforts to revitalize agriculture with large-scale state farms have been constrained by a severe shortage of skilled labor and investment capital, and a revival of industrial production has been hampered by the suspension of import licenses for industrial raw materials in the second half of 1979. The non-oil mineral sector has also languished. Diamond production is still far below the two million carats produced annually prior to independence, and output of iron ore—3.1 million tons in 1974—remains at a standstill.

The oil sector, however, is booming. Reserves are estimated to be at least 300 million tons, 140 million of which are proven. Oil output is expected to average 160,000 barrels per day (bpd) in 1980, up from 146,000 in 1979. With domestic consumption projected at about 13,000 bpd this year, exports averaging some 147,000 bpd are likely, versus exports of 135,000 bpd last year. Gross oil export revenues are thus expected to rise to $1.9 billion from less than $840 million in 1979, with the majority of revenues derived from North America—60% from the United States alone in 1978. The Angolan Government has shared production with foreign oil companies and will continue to do so, although it plans to place its oil distribution system under state ownership. It also plans to apply for OPEC membership.

Oil exports will account for some 83% of the $2.25 billion in total export earnings projected for 1980. This level is almost double export receipts last year. Thus, despite total imports likely to rise to an estimated $1.4 billion this year (37% of which are of foodstuffs, with the remainder mostly capital equipment), a trade surplus of $850 million is forecast, up sharply from the $50-million surplus of 1979. A negative invisibles balance of about $350 million is expected, owing to the outward remittances of foreign technical personnel. This points to a current-account surplus of roughly $500 million this year, in contrast to a deficit of $35 million in 1979.

Although capital goods imports will probably climb steeply along with widening deficits on the invisibles account, steadily rising oil earnings and a strong potential for a broadened export base point to current-account surpluses for much of the current decade. Even so, the Angolan authorities have sought to maintain creditworthiness in international financial markets by promptly meeting debt payments and even assuming the credit obligations of the pre-independence regime.

Foreign investment courted

Underscoring its desire to rebuild its economy as rapidly as possible with Western investment, the Angolan Government promulgated a liberal foreign investment law in June 1979. The law guarantees foreign enterprises at least 10 years of business activity, provides for compensation in the event of nationalization, allows repatriation of annual profits of up to 25% of invested capital, and permits access to domestic credit for financing current operations. It excludes foreign investment in defense, financial and insurance institutions, external trade, public services, and the media. The law's liberal provisions have attracted substantial interest from European, Brazilian, and American businesses, with major contracts already signed by a number of foreign oil companies.

The Angolan economy could experience a rapid takeoff in the current decade, given its natural (and particularly, oil) resource wealth, and its encouragement of foreign investment. Much, however, will depend on the authorities' ability to maintain political stability and also on a relaxation of tensions on the southern border with Namibia. Resolving the latter problem would permit a reduction in the 25% of total budgeted outlays now allocated to defense, restore full service on the vital Benguela Railroad, and exploit the vast agricultural richness of the southern region. If political stability is maintained, and coupled with sound demand-management policies that favor investment, Angola could enjoy rapid economic growth in the 1980s.

Wally V. Koch

Belgium Faced With Widening Deficits

Belgium's open economy has yet to recover fully from the OPEC oil price shock of 1973-74. Prior to 1973, inflation-adjusted economic growth was brisk and steady—averaging 4.8% per annum between 1960 and 1973—and the external accounts were generally in surplus. In the latter half of the 1970s, however, industrial production has been virtually flat, manufacturing investment has fallen continuously, and the external-account deficit has widened sharply.

The 1973-74 oil crisis forced a severe economic adjustment. With virtually all wages and salaries indexed to the cost of living, a downward adjustment in real wages was essentially precluded. Consequently, the full brunt of the adjustment fell on industrial profits, investment, and employment. Moreover, periodic speculative attacks on the Belgian franc had to be countered with restrictive monetary policy, which further undermined industrial investment and employment. The consequent loss of export competitiveness—so critical to a country whose foreign trade is equal to one-half of GDP—could not be offset by a currency devaluation because the resulting higher import prices would only have shown up in higher wage costs.

Responding to the rise in unemployment, the authorities stepped up public spending and expanded the public deficit. This sustained domestic demand temporarily, but created a current-account shortfall and necessitated substantial foreign borrowing. The government's external debt grew from virtually zero in 1977 to $2 billion as of end-1979 and rose to $3.1 billion in March 1980. While such a foreign debt burden is relatively low, the trend underlines the need for an external reduction in the current-account deficit.

After advancing 2.5% in 1978, the pace of real GDP growth stepped up last year to 3.5%, the result of highly stimulative fiscal policy and faster world trade growth. At the same time, the public-sector deficit rose to a level equivalent to 9% of GNP from 7.2% in 1978. Stimulated by rapid economic growth in Europe, export volume rose 4% last year, but this was still less than the growth in the import volumes of Belgium's trading partners so that the country continued to lose market share.

Membership in the European Monetary System held the rate of inflation to 4.4% last year, roughly approximating Germany's 4.1% rate. But strong domestic demand boosted import volume 5.7%, which, coupled with costlier oil imports, widened the country's current-account deficit to $3.8 billion from $880 million in 1978. Some $2 billion of this deterioration was the result of a net oil bill that reached $6 billion.

Despite a continuation of expansionary fiscal policy, a sharp slowdown in Belgium's real economic growth appears likely for 1980, along with further widening in the balance-of-payments deficit. The major sources of weakness are exports and investment. Export volume growth is expected to fall to 1.5%—reflecting the European economic slowdown—and private investment is forecast to decline because of the continuing squeeze on profits, high interest rates, and slower growth in consumer spending.

Domestic demand will likely be sustained somewhat by a further rise in the public-sector deficit to 9.4% of GNP. This increase in government expenditure will occur despite earlier proposals to cut spending drastically, which continue to be blocked by political difficulties. Prime Minister Wilfred Martens submitted his government's resignation on October 4 over a dispute concerning cutbacks in social security and unemployment benefits. A fourth Martens coalition government was just sworn in, but it remains to be seen whether it will be any more successful in reducing the public-sector deficit.

All told, real GDP growth of only 1.5% is projected for 1980, less than half last year's rate. And the rate of inflation is forecast to climb to 6.5%, the result mainly of higher import prices. But the most worrisome feature of the Belgian economic performance in 1980 is the balance of payments. This year's rise in oil prices will add about $3 billion to the net oil bill. And with domestic demand growing faster than export demand, the current-account gap could top $7 billion.

The size of the current-account gap may bring about some shift toward a more restrictive fiscal policy late in 1980—subject to a resolution of the current political uncertainty—which would portend a further slowdown in domestic demand in 1981. Although recession in Belgium's trading partners is likely to continue until mid-1981, foreign demand should accelerate in the latter part of 1981. Thus, 1981 will also see slow economic growth, but with improvement likely in the second half. Inflation can also be expected to ease in line with inflation rates throughout Europe, and the current-account deficit may decline somewhat, assuming no further drastic cutback in oil supplies in the wake of the Iran-Iraq war.

The alarming growth of Belgium's current-account deficit must ultimately be addressed. Reducing the deficit can be accomplished in either of two ways: abandoning wage indexation and devaluing the franc, which would reduce real wages but boost output and employment; or deflating domestic demand with restrictive fiscal policy, which would further increase unemployment. Both of these options, however, are politically difficult. Nonetheless, in the event that external pressures mount—perhaps in the form of harder terms on foreign credit—the necessary political consensus will very likely emerge.

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